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PUBLIC-PRIVATE PARTNERSHIPS: THE ENABLING ENVIRONMENT FOR DEVELOPMENT

Report prepared by the Secretariat

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INTRODUCTION

1. To many people today, the remedy for bad government is simple: governments should hand over their activities to the private sector, which will do a far more efficient job. Partnerships are not necessary, they say, only hand-over. In this paper we will argue that this is only part of the answer, that governments will have a larger role to play in the future and that they will play that role increasingly in collaboration with the private sector.

2. Public-private partnership implies a common understanding of shared goals, a willingness to repartition responsibilities for their achievement, a continuing public-private dialogue on what needs to be done to promote their realization, and a supportive policy and institutional framework. Partnership goes beyond business concerns, and extends into all policy areas, including education, health, human rights, immigration and citizenship, science and technology, foreign relations, arts and culture. There is a widespread trend to broaden participation in governance by strengthening the interface between the state and non-state actors.

3. This has important political dimensions. In its resolution 50/225 of 19 April 1996, the General Assembly reaffirmed that democracy and transparent and accountable governance are indispensable foundations for the realization of social and people-centred sustainable development. Participation reinforces democracy by making the government more responsive to users of government services and to citizens generally, and making government more open, transparent and accountable. New machinery is set up such as administrative tribunals, ombudsman offices, joint committees, and charters of the rights of citizens (or users, "clients" or "customers" of government services), which tend to make the government agencies which have immediate relationships with the public more accountable and answerable to those affected by their activities. This "direct" accountability complements the indirect accountability of agencies via the political directorate to legislative bodies and heads of State and, in democratic regimes, to electorates.

4. This paper looks at partnership in the pursuit of national economic goals, with a focus on some innovative examples of partnership, and some of the main issues arising. The paper is divided into four main sections, which deal respectively with increasing opportunities in the private sector, the business-enabling environment, promotion of competition and social regulation, and a final section which briefly touches on the role of the international community with regard to the foregoing.

I. INCREASING OPPORTUNITIES IN THE PRIVATE SECTOR

A. Privatization

5. The adoption of large-scale privatization programmes gained considerable momentum worldwide in the wake of the British experiment of the early 1980s. This phenomenon has changed the respective roles of the public and private sector worldwide. Projects and activities in sectors which were formerly

government monopolies, including physical infrastructure and social services, are being increasingly financed and/or managed by private firms under negotiated programmes and contracts. There is a spectrum of disengagement by governments and engagement of private firms in productive activities, including contracting out (also called outsourcing, service contracting or alternative delivery) (see paras. 16-21 below), turnkey construction, management contracts, leasing, concessions/build-operate-transfer, partial disinvestment/joint ventures, and full disinvestment. A particular type of disinvestment which is of central importance in post-conflict countries is the conversion of military installations, personnel and industries to civilian purposes (see paras. 22-28).

6. In terms of the percentage share of GDP produced by private firms, privatization has been most rapid in the countries of eastern and central Europe. The EBRD Transition Report (EBRD 1994) examined privatization in 25 countries of eastern and central Europe and central Asia. In these countries the share of the private sector had risen to about 40 per cent by mid-1994, with the Czech Republic leading the way at 65 per cent, up from 3 per cent in 1986 (see Milanovic: 1989 for other country estimates). The main source of the higher private share in the transitional economies has not been the disinvestment of public enterprises, as might be expected, but rather the faster growth of private enterprises compared with the public sector. Liberalization and the institution of a strong legal base for protecting private ownership have together paved the way for the rapid emergence of private enterprises in these countries.

7. A recent World Bank study (1995) confirms that private sector growth is the major modality of privatization in the developing countries also. Actual disinvestments have been few (less than three per country per year), so the rise in the private share has been due more to the faster growth of the private sector compared with the public sector than to the transfer of enterprises from public ownership to private ownership. This trend may be expected to continue as State-owned enterprises have been taking a smaller share of gross domestic investment.

8. For most developing countries, a clear enunciation of the goals of a privatization and private sector development programme is a necessary prerequisite to any programme implementation. To this end, a matrix of legislative, regulatory and institutional mechanisms directly related to the implementation of the programme needs to be put in place or established at the outset. Training of high-calibre national technical personnel in the oversight and guidance of privatization and private sector development programmes is another significant prerequisite to the implementation and backstopping of the programme. The cadre would be responsible mainly for the preparation of terms of reference for the valuation of enterprises to be privatized, and the selection of qualified personnel to carry out these privatizations and assessing the impacts of the programme, e.g. on employment.

9. Most governments view the provision of basic needs to the lowest income groups as a basic political and economic goal. Because economic re-balancing can worsen income distribution in the short run, the provision of safety nets helps to build public opinion in favour of the programme. The creation of well-targeted safety nets is an integral element in the economic development or

transition of a country. In order for safety nets to be truly effective, they should not be regarded as a substitute for other more significant national policies targeting education, primary health care, and disease control. Rather, safety nets should offer only a temporary and limited relief in a time of structural unemployment.

10. A recurrent problem in privatization by disinvestment is undervaluation. Governments tend to undervalue and sell public enterprises too cheaply and, in some countries, this has been associated with corruption and given privatization a bad name. There are some legitimate reasons for undervaluation, as well as illegitimate reasons, so the problem is to know the difference. In uncertain capital markets, it is usual for the issue price of shares to be set below the expected market value after issue, so as to reduce the risk of failure and avoid the need for underwriting. Many governments have tried to sanitize privatization by broad-basing ownership. This partially corrects for any undervaluation (or overvaluation) and improves the equitable distribution of wealth and subsequent income. On the other hand, it tends to dilute the control of those who have the best ideas about the future directions of the enterprise. This reduces the efficiency dividend. In Sri Lanka, the Government preferred to sell 60 per cent of the equity in each enterprise to a single well-qualified buyer, and broad-base the ownership of only the minority equity, neatly balancing both efficiency and equity objectives.

11. How to reconcile efficiency with equity remains a leading issue in the transitional economies. Equity calls for the distribution of public assets to the people at large, not to those who are able to pay the most for them as a consequence of their (often illegal) amassing of wealth in an earlier regime. This implies free or near-free distribution of shares, as has happened in several voucher schemes. Efficiency, on the other hand, requires that effective control of assets is in the hands of those who have entrepreneurial vision of how they can be most productively used. For this to take place, enterprises must be offered to the highest bidders and potential entrepreneurs must be able to borrow. If vouchers are tradeable and the trading machinery is in place, it can be expected that property rights will eventually gravitate to those who value them most highly. Though this reconcentrates ownership, the equity goal is still served as the initial holders of vouchers sell them at higher prices which final holders are willing to pay. In theory, everyone gains from this process of concentration of property rights. However, the model depends on good company law and capital market regulation: in practice, managers block the emergence of strong external governance. Poland is attempting to establish effective governance over corporate managers through professionally managed national investment funds.

12. Studies of the process of privatization have shown that there are two common reasons for the slower rate of privatization in poorer countries: (a) the relatively higher difficulty of privatization where domestic savings are low; and (b) undeveloped banking, managerial, accounting and legal skills and institutions. This constrains the transitional economies and the least developed countries in proportion to the imbalance of needs and capacity. In effect, the rate of development of this institutional infrastructure determines the optimal rate of privatization (Metcalf and Ambrus-Lakatos 1991). If the rate of privatization is forced beyond the institutional and professional

capacity of a country, it is likely that it will not result in the intended benefits or that it will not be sustainable. The early experiences of Chile and Bangladesh are examples of this. It is now well recognized by the international community that policy reform has to be accompanied by institutional and human resource development, and that this is a medium- to long-term process (see paras. 59-64 below).

13. The pace of privatization in some countries, such as Sri Lanka, has been determined mainly by pressure from international donor agencies (where aid has been conditional on privatization) and from domestic capital market interests. This has had unfortunate negative consequences, such as lower prices from purchasers and little attention paid to transparency. In Sri Lanka this led to allegations of impropriety, public protests and a slow-down in the privatization programme in mid-1992 (Kelegama 1997).

14. Lack of transparency, of course, is more of an issue in trade sales to a single buyer than in stock market issues where elaborate rules of disclosure usually apply. Trade sales have had a political price in Sri Lanka, Mexico and other countries. Governments typically start with a tender procedure which is intended to give all potential purchasers adequate and equal opportunity to make their independent bids, then an award is made to the highest bidder who meets all the prescribed conditions. Even if this works as intended, it is usually only the starting point for protracted negotiations leading to a final settlement and transfer of the enterprise. This is the point where transparency may be lost, as the conditions attached after the bids are invited may entirely negate their ranking. There are many cases of governments modifying the conditions laid down at the point of tender, or giving undertakings as to protection of the company's domestic market, guaranteed sales, or other policy sweeteners. The fact that these negotiations are always carried out behind closed doors does not create public confidence that the best possible deal has been made.

15. A campaign to inform and educate the public on the privatization programme is an important component in its overall success, but not a sufficient condition for public acceptance. Transparency relates to the terms of individual transactions. A simple requirement that the final contract be published, omitting any commercially sensitive data, together with all bids and the criteria of evaluation (as is done in Ghana, for instance), has important advantages: first, it would protect the negotiators from charges of impropriety (or alternatively, provide a clear basis for their accountability); second, it would avoid unnecessary suspicions, charges, investigations and delays.

B. Contracting out

16. Just as governments are facing up to the challenge of hiving off their public enterprises to private ownership and/or management, at the same time they are examining their own expenditures, at central and local levels, with a view to identifying activities that could be contracted out to private firms at lower cost to the public purse and higher quality to users. "Alternative delivery" of public services opens up options which many governments are exploring. Services to the government such as office cleaning, canteen services, buildings and

grounds maintenance, printing and legal services and the contract leasing of vehicles are common examples. Services by government agencies which are widely contracted out include the collection and disposal of solid waste, street cleaning and lighting, road maintenance and almost all infrastructure construction. Less frequently contracted are the "preventive" services, such as prison detention and corrective services (which are contracted out in Australia, the United Kingdom and some states of the United States of America), environmental monitoring (e.g. water standards in Chile) and tax collection (Chad, Indonesia). Some hard-pressed governments have contracted out even defence to mercenary forces, though most democracies would prefer not to have their national security left to private armies.

17. If the public goal is simply economic, that is, to provide quality public services at the lowest possible cost, the decision to contract out a service depends on the supplier's price, plus contract administration costs, being less than the total costs of in-house production as before. This simple calculus implies that contracting out should be decided on a case-by-case basis, even if there is a general policy in favour. The rule is often forgotten, particularly the need to include contract administration costs in the equation. Even in the industrialized countries, few government agencies have any idea of what they are spending on contract letting, administration and monitoring, though one survey found that these costs added up to an average of 16 per cent of contract cost, with wide variation from one service to another (Stevens 1984). A more sophisticated analysis would also take into account the disposal of assets that may no longer be needed and the costs of personnel resettlement (Prager 1992). For many governments, the personnel implications are all-important, since long-term contracting out implies a movement of personnel out of the government service to independent contractor or contractor employee status. Governments may make it a condition of contracting out that the contractor absorbs both the fixed assets and employees formerly in government service. There may be retraining costs, terminal payments and compensation for loss of job security.

18. In countries which have made the greatest use of contracting out, such as the United States of America and the United Kingdom, the studies are almost unanimous in their finding that costs are saved without loss of quality, and even with gain in quality. Cost savings are typically in the range of 20 to 30 per cent of the former cost of government provision (Savas 1992), despite the requirement (in the United States) that contractors pay their workers no less than prevailing wages. Developing countries and countries in transition, however, should not expect the same magnitude of savings unless there is keen competition among potential suppliers. The less the competition, the less the potential savings by a change to competitive bidding. Gains could be in quality rather than cost: in Jamaica, the contracting out of hospital dietary services actually led to an increase of government expenditure as standards were raised substantially.

19. One alternative delivery option is to improve the existing service and to "contract in". In-house providers should always be given the opportunity of reviewing and re-engineering their own operation so as to make themselves more efficient, if necessary by separating themselves from administrative red tape in order to be more flexible, as in the "executive agencies" of the United Kingdom, Australia, New Zealand and Singapore. The prospect of losing work to an outside

agency brings out innovative thinking and willingness to reform obsolete work practices. In practice, competitively bid contracts are often won by the in-house provider. In the United States, federal government agencies win contracting-out competitions 40 per cent of the time (report of the President's Commission on Privatization, 1988). In the United Kingdom, where local authorities are required by law to put services to competitive tendering, in-house providers are now getting the majority of total contracts.[1] The efficiency and savings come, not from privatization per se, but from the introduction of competition. Savings are sustainable for as long as competition is maintained.

20. A major advantage accruing from the preparatory work for contracting is that government agencies are forced, often for the first time, to define and specify, in a monitorable form, exactly what services they are providing, to whom and to what standards. Thus, even if the service is not ultimately contracted out, valuable data is provided for better planning and supervision.

21. There are five main constraints on the development of government contracting which are commonly experienced in developing countries:

(a) Political leadership to envision such public-private collaboration and to push for its realization, often against political and labour opposition and vested interests in the civil service;

(b) Lack of sufficient firms to establish competitive bidding. This may be due to a government-imposed monopoly, which can be removed by deregulation, or it may be a simple consequence of a past tradition of government provision, such that no entrepreneur has tried to bid. The first step is an analysis of capacity of potential suppliers. Where there is insufficient competition, the government may divide the work (e.g. geographically) between outside contractors and inside workforces, as is done for instance by the city of Bogota, Colombia, where solid waste collection is shared between public and private agencies, with a private firm made responsible for monitoring the operations of all the agencies.[2] Continued government provision of at least part of the service provides in-house knowledge of costs and technology changes and thereby some protection against inflated contracts;

(c) Scarce administrative capacity to draw up, negotiate and monitor contracts in an impartial and non-corrupt manner, to structure partnerships and to ensure that they operate in the public interest, while maintaining independence and avoiding conflicts of interest or regulatory capture;

(d) An organizational implication of contracting is the need to make the contract unit independent of the operations unit (the Chinese wall problem); if these are branches of the same ministry or involve former colleagues, they may act in collusion. Even without collusion, it is necessary to ensure that in-house units do not underbid to get contracts, secure in the knowledge that a loss on the contract will be met by the government;

(e) Lack of accounting data or unreliable data to make good decisions, e.g. on the economics of contracting out. As government accounting is almost

everywhere on a cash basis, not a full-cost accrual basis, the cost of in-house operations is likely to be understated.

C. Military conversion

22. Military conversion can be divided into five areas, namely: (a) military industry; (b) military sites; (c) research and development; (d) demobilization; and (e) surplus weapons. They offer different challenges and opportunities and vary in their application to the industrialized countries, the economies in transition, and the developing countries. Like technological adaptation in the civilian sector, conversions provide tremendous opportunities for private sector development. In fact, conversion may be part of the broader transformation of societies, as in the case of Angola, Bosnia and Herzegovina, Cambodia, Egypt, Ethiopia, Guatemala, Panama, South Africa, Viet Nam and Zaire. Thus, the process of military-to-civilian structural adjustment is complex and dynamic.

23. As with all privatization, conversion initiatives can only be sustainable in favourable political, legal, economic and social frameworks. In many instances, there is a geographical concentration of military sites and industries. This aggravates the impacts of conversion on the stakeholders in such sites and industries, particularly the local stakeholders and their families, namely the men and women in uniform, the workers, managers, local private enterprise suppliers, local governments, etc. Sustainable conversion can only benefit from the active engagement of the local stakeholders in setting up priorities for future public-private initiatives in manufacturing, services, research, education, training, etc. as illustrated by the cases of Subic Bay in the Philippines, and sites in Europe and the United States, where all stakeholders, at different levels, have been organized to join partnerships in order to respond to the problems of the redevelopment of the closed bases and restructuring of defence industries. Generally speaking, conversion processes stand a better chance of success when they are integrated into the development of a country or region.

24. Since the ultimate resource in conversion is human capital, the engagement of workers and managers of military sites and industries in conversion planning and implementation can be more important than the reallocation of physical assets. Usually, the military industries and sites attract some of the best technical talents in a country. This human capital is an important component in viable conversion to knowledge-based sustainable activity, and constitutes a pool from which private sector managers and entrepreneurs can evolve.

25. The setting up of public-private partnerships can be facilitated by promoting stakeholders' dialogue and consensus, as this empowers the constituencies closest to the issues of conversion and helps build up solidarity among them. Conversion can be greatly stimulated by the expansion of existing networks to the developing countries and the economies in transition, thus truly globalizing them. Dialogue also contributes to curbing corruption and other illicit practices by the exposure and sharing of information, keeping the process transparent to all concerned, and promotes market forces as it spreads information throughout the immediate markets affected. Dialogue would also help

improve coordination at all levels of government for mutually reinforcing actions.

26. In the former centrally planned economies there is a natural reluctance to create redundancies, particularly in areas of large concentration of military sites and industries which have few immediate employment alternatives. For these countries, and in developing nations also, social safety nets have been designed for displaced workers, together with training programmes to develop new skills required by private firms in new markets. The set of skills required of a converted enterprise - site or industry - is often radically different from that necessary to the original company. Thus, conversion needs a radical change in attitudes of the workers and managers involved. Countries such as the Russian Federation, China, Belarus, Ukraine, Poland, Cambodia, Viet Nam, Argentina and Egypt in the last several years have either initiated various training programmes or established institutions as clearing houses, training centres and business promotion intermediaries.

27. As the political, economic and military reorganization of the world takes shape, the resources spared by the overall decline in military budgets - the peace dividend - could, in principle, help finance sustainable development initiatives. But there is so much competition for these same resources that the peace dividend cannot be taken for granted. Thus, the implementation of initiatives for military conversion must find resources from a diversified portfolio of sources, some conventional, others non-conventional, as exemplified by debt swaps, buy-operate-transfer (BOT) finance, offsetting of government civilian procurement, etc. One such source, often overlooked, is the hidden resources represented by waste in existing military activities, which could lower the capital requirements for new, converted sites and industries. In St. Louis, Missouri, United States, several projects have been launched to identify the hidden resources - equipment, technology and skills - to be used for community development and new business start-ups.

28. Public-private partnerships, whether entirely domestic or involving foreign partners, are worth promoting as a means of realizing and expediting conversion. Small and medium-sized enterprises which have a high collective employment potential could especially be promoted, such as service businesses, originating from military research and development, manufacturing or military sites, which require much less capital per worker, e.g. health services, warehousing, port and airport services, maintenance and repair services, tourism, education, training, consulting, information services.

II. BUSINESS ENABLEMENT

A. Public-private dialogue

29. Where government is the dominant institution in a country, only the government can lead in envisioning and planning the policies and support institutions and infrastructure - physical and human - for businesses to thrive in an enabling environment conducive to private sector investment and growth. Support institutions may include specialized agencies in fields such as finance, research and development, acquisition of technology, export promotion, market

intelligence and human resource development, which may need government sponsorship pending the development of markets for their services.

30. Many areas of policy impact on business. Particularly important are policies on trade and liberalization, deregulation, privatization, competition, education and training, labour, investment, taxation and the environment. Unilateral decision-making by governments in these fields is a blunt instrument. Greater realism, precision and effectiveness is possible by drawing on the experience of the private sector. The business consequences of draft policies and programmes need to be explored with relevant private sector representatives. Regulatory reform, for instance, requires a partnership between government and the private sector, so that essential social objectives are met without killing the goose that lays the golden eggs (paras. 51-64 below). OECD notes a strong trend towards renewal and expansion of public consultation in regulatory development. A well-designed consultation programme can contribute to higher quality regulations, identify more effective alternatives, lower costs to business, achieve better compliance and faster regulatory responses to changing conditions (OECD 1995). On the other hand, it slows down administration and may weaken the authority of decisions (Braibant 1996).

31. In some countries the government has interacted closely with the private sector and promoted a sense of partnership in the pursuit of national goals. This has applied particularly to partnership with the business community in order to promote export-led economic growth. Partnership is promoted (a) by setting up a structure of interactive interventions - business councils, consultative committees, ad hoc committees, advisory commissions, etc. and (b) by reorienting civil servants away from dysfunctional attitudes to business (characterized by arrogance, distrust, envy) and in favour of pragmatic problem-solving towards shared goals. Stereotypes and misconceptions of business ("we work to serve the public: they work for profit") have been replaced by positive attitudes, such as Prime Minister Mahathir expressed to Malaysian civil servants: "Why shouldn't civil servants help the private sector make money? Who really pays the salaries of the civil servants ... if not the business people?"[3] At the same time, the business clamour for subsidies and tax breaks has been replaced by attitudes of self-reliance. These changes were achieved in Malaysia by sustained strong political leadership, massive training, and an administrative reform programme which proceeded in parallel.

32. The specific aims of the Malaysian, Singaporean and other governments have been to get private sector understanding and feedback on the operation of policies, rules, regulations and procedures which affect their economic performance, and suggestions for changes which are in the general interest. The main areas of interest have been business licensing, taxation, import and export procedures, physical infrastructure - all the areas which make up the enabling environment for business, which in practice are often more disabling than enabling.

33. In Malaysia, public-private interaction, in a formal sense, dates back at least to the establishment of the Industrial Advisory Council of 1979 but took off in 1983 under the banner of "Malaysia Incorporated". The country's impressive growth since then has been widely attributed to this policy. The benefits have been: (a) wider understanding of government strategies, policies

and procedures, (b) private sector "voice" in the determination of strategies, policies and procedures, which in turn has promoted democratic consent, transparency in the decisions and actions of government, and market efficiency (through lower transaction costs), and (c) an appropriate balance between stability and change in government policies.

34. The process depends, as in any partnership, on the prospect of gain by all participants. Though there is frequently great stress on common goals and values, in fact business and government representatives may have differing goals and values, particularly on regulatory issues, and different perceptions of how they are to be achieved, and yet reach mutually beneficial agreements. Where panels or committees do not have agendas of interest to all participants, or where little useful change can be expected, attendance drops away. The majority of ad hoc forums in Malaysia have not continued after a couple of meetings (Chang 1996).

35. The machinery in Malaysia is extensive. There are consultative panels in most ministries and departments at Federal, State and district level. Lower level structures parallel the Federal structure, which was the first to be developed. Mostly they are created by administrative direction on the initiative of the Government, though some, such as the Industrial Advisory Council, were created by statute, and some (mainly informal) meetings are called by the private sector. Their origins and constitutions do not matter so much as their membership and agenda.

36. On the government side, the highest council, the Business Council, is led by the Prime Minister, the annual budget dialogue is led by the Minister of Finance and annual dialogues with industry by the Minister for Trade and Industry. The private sector is represented by employer associations for each of the main ethnic groups, and State-owned enterprises, while foreign investors are represented by transnational corporations. In some important fora, such as the Business Council, the media and academic institutions are also represented. Until recently, labour was not represented. This reflected the earlier lack of confidence, as in other East Asian countries, in the ability of labour unions to take a national view of issues. Labour has now been included in the partnership because its leaders have subscribed to the national leadership and ideology, and also because their participation has become more crucial in conditions of labour shortage (Chang 1996).

37. One issue is the limit to cooperation. Where the government performs a balancing role, looking after the interests of other groups (such as customers in the area of utility tariff regulation) as well as business, the relationship should be at arm's length rather than cosily cooperative. The reverse side of the partnership coin is the risk that civil servants and big business collude in their own interest at the expense of the general public, or at the expense of groups such as small and medium-sized enterprises which are left out of the mainstream of collaboration (see paras. 40-50 below). The risks of corruption, mutual favours, and "regulatory capture" are higher where the two sides come from the same socio-ethnic groups, and where social interactions such as social and sports meetings are promoted as well as strictly business interactions. Connections with the right people may be used to secure contracts, licences, import permits, etc. It should also be remembered that many of the regulatory

personnel and many of the managers of the privatized State-owned enterprises were former colleagues in the same departments. This danger is recognized in Malaysia where General Orders and two circulars in 1993 have prescribed the acceptable standards of behaviour by public officials.

38. An issue which is not widely recognized is the potential conflict between government support to industry, and in particular to exporters, and the rules of the World Trade Organization. The Agreement on Subsidies and Countervailing Measures (ASCM) defines the concept of "subsidy" and establishes disciplines on the provision of subsidies. A subsidy involves a financial contribution by a government or public body, which confers a benefit. Almost all goods or services provided by a government other than general infrastructure would appear to be subsidies as defined by the ASCM. This contrasts markedly with the common practice, by all governments, of subsidizing exporters by means of tax incentives, government funding of research and development, tied official aid, export credit guarantees, commercial intelligence activities through foreign diplomatic representation, and high-profile trade missions (Economist, 1 February 1997).

39. The constraints to the development of partnerships are mainly attitudinal and organizational. The prevailing culture of government may include risk avoidance, secrecy, and suspicion (even antipathy) for the private sector. Reorientation training can displace the established culture and bridge the gap between public and private, but widespread change is a long-term process, particularly in former centrally planned command economies in which entrepreneurial activity has only recently been decriminalized. Productive interaction with the private sector may be used to reinforce responsiveness, transparency, impartiality, objectivity and accountability as major professional values of the civil service.

B. Promotion of entrepreneurship and small enterprises

40. There are a number of unique features in small enterprises, including in this term micro-, small and medium-size enterprises (SEs), that can help to explain their key role in a nation's economic success. Although entrepreneurship is important for all types of enterprises, it is especially important for SEs, which typically constitute the bulk of total enterprises by number. In many countries enterprises in these categories account for more than half of industrial employment and as much as a third of the national product and export earnings. They tend to be highly innovative, make excellent use of scarce capital and skills, and provide a range of services and goods to the large corporations. In countries in which economic units are often too large to be economically efficient, many new small units are needed because they are responsible for a great deal of technological progress. The lack of small-scale entrepreneurs, especially the "missing middle" (small and medium-sized entrepreneurs in the modern sector), is a handicap to economic progress.

41. However, SEs face many constraints. Generally, they lack access to capital, appropriate technology and information about national and international markets. In some countries, particularly the former centrally planned

economies, government policies and business attitudes do not favour SEs, and even create barriers to their operations.

42. The task of promoting small enterprise development involves essentially two main strategies: they can be loosely characterized as a top-down/indirect approach and a bottom-up/direct approach. The top-down approach seeks to create an enabling or "fostering" environment, which provides the right incentives for small firms, together with enough positive support and protection (e.g. against unfair practices of larger competitors) to allow such firms to make the best of their potential.[4] The top-down approach seeks to improve the business environment by operating on macroeconomic variables such as prices, government regulations and policies, by providing legislation and enforcement, and by building up the physical infrastructure. The second strategy, the bottom-up approach, aims at supporting small enterprises directly by mobilizing indigenous resources, creating or reinforcing local institutions and support systems, and with the active participation of beneficiaries. Central and local governments, decentralized government bodies, financial institutions, business and industry associations, chambers of commerce, universities, international organizations and donor agencies have worked, independently and together, in both the creation of an enabling environment and the provision of direct support to small enterprises.

43. In the past, most small enterprise policy has focused consciously on fostering timely access to the factors of production and to markets, with the involvement of state development banks, public sector technical assistance, etc. Rather than complementing and cooperating with private entities in, say, the financial and technical assistance areas, governments have substituted for what was felt to be the inadequate performance of the latter. Part of the challenge at present is to find ways which make private markets work better rather than replacing them. One view gaining widespread acceptance is that governments should concentrate on creating the enabling environment, including macroeconomic policy-making, legislation and enforcement, catalytic promotion and regulation and that direct support to the sector should be provided by private individuals, firms and non-government organizations.

44. There are a number of situations in which partnership between public and private sector institutions is the most efficient and effective mechanism, due to the presence of mutually reinforcing goals - which in the final analysis converge towards an equitable and sustainable economic development of the country - and to the complementarity of capacities and roles. Through partnership, governments and private entities assume co-responsibility and co-ownership for the promotion of small enterprises. Through these novel modalities, the advantages of the private sector - dynamism, access to finance, knowledge of technologies, managerial efficiency, entrepreneurial spirit - are combined with the social responsibility, network of contacts, environmental awareness, local knowledge, and job generation concerns of the public sector. For example:

(a) The government farms out the functions which need to be performed for SE promotion, such as organization of support/regulation systems, to private entities, seeking when possible the joint financing of such initiatives;

(b) The government allocates a specified share of government procurement to SEs;

(c) Public-private partnerships are established for the creation of institutions such as business support centres, business incubators, industrial parks, or centres to disseminate technical and commercial information for small enterprises. These institutions are usually, and optimally, financed and/or operated by both public and private sector entities, such as universities, public development corporations, development banks, industry and entrepreneur associations, venture capital firms, etc.;

(d) More cooperation of local authorities (and less involvement of national governments) with local NGOs, industry and entrepreneur associations and universities. For example, the impressive performance of Italian small enterprise (e.g. in international markets) is due to the effective interface between municipal government (with a long and special involvement in the local economy) and small business;

(e) The establishment of institutional mechanisms for dialogue between the government and interest groups representing small enterprises, viz. industry associations, entrepreneur associations, chambers of commerce, cooperatives (as described in paras. 29-39 above). The development of effective means of consultation with the private sector is essential even for decisions which must remain in the public sector. The importance of involvement by business associations lies in their direct knowledge of the needs of their affiliates and the mobilization of collective action on other fronts.

45. Some of the policy areas relevant for the success of SEs where public-private cooperation appears to be the most suitable mechanism for support include: entrepreneurship, managerial assistance, access to financing and to technology. It is generally accepted that technology provides growth in output and tangible improvements in efficiency and productivity. For this reason, access to appropriate technology, together with an effective technical and managerial assistance programme, is vital for the development of small enterprises. But, as with financial resources, it has proven difficult to develop such programmes. When they are lodged in the public sector they must often overcome weak staffing and lack of incentives to have a good chance of success. When they are lodged in the private sector they are typically too expensive to be of much relevance to small enterprises. The inability of SEs themselves to access adequate technological and managerial resources, together with the modest efforts of governments, indicate the need for a synergistic partnership.

46. The United Nations EMPRETEC programme, now operating successfully in 10 countries in Latin America and Africa, promotes entrepreneurship on two levels - the national policy level by creation of legal and institutional infrastructures conducive to SE development, and by capacity-building of both national institutions and individual entrepreneurs. By working closely with governments, business organizations and SEs themselves, EMPRETEC influences national policies in the areas of taxation, insurance and labour law, and is midwife to the creation of business support centres, entrepreneurs' associations, cooperatives and international networks. Typically, the EMPRETEC business support centres

established in each country are active coalitions of public institutions, private business associations, national and foreign companies, and multilateral organizations, led by National Executive Committees comprising high-level public officials, entrepreneurs' representatives and prominent business leaders from local and multinational companies operating in the country. These have proven essential in setting the institutional base of the programme and in securing its capacity for self-financing after initial donor funding.

47. For an optimal environment, entrepreneurs and SEs need to be recognized and valued by policy makers and society. In many transition economies, SEs have only recently emerged from the black market and gained legitimacy. New entrepreneurial ventures in particular require confidence-building measures from governments and society. One of the first adjustments that governments and societies must make is to overcome a cultural constraint and accept the idea that profit-seeking is healthy, that entrepreneurship and free enterprise can be in the best interests of the greatest number of people. For effective public-private partnership in economies in transition, the greatest need is for an entrepreneurship-friendly environment, including institutional, legal and cultural infrastructures. This will ensure a political and economic system where business risks will be rewarded and returns protected, contracts can be enforced and the social order upheld. Mechanisms of public-private cooperation in fostering the entrepreneurial culture include the introduction of entrepreneurship education and training at public schools and management institutions, where the training is carried out by private sector institutions. Other mechanisms include joint advertising campaigns, establishment of public honours and recognition of merit of successful entrepreneurs.

48. Lack of financial accommodation is reported as the principal problem of small entrepreneurs. One of the reasons for the limited access of SEs to capital from the formal financial sector is the higher administrative cost and higher default risk as perceived by the financial institutions. Such cost differentials go a long way towards explaining why credit goes disproportionately to the large-scale sector. Lack of collateral and security and an undefined legal framework contribute to this bias. Commercial financial institutions cannot easily provide a large flow of credit in small loans to firms with no track record, no guarantee and no security. Another important reason, however, is that some private and public banks have special relationships with their large clients; they may, for example, be part of the same conglomerate. Thus, favouritism towards the "related" companies is natural and inevitable in these cases, but at the same time its presence calls for a corrective action to "level the playing field" among potential borrowers. It is in this direction that public-private cooperation and other innovative and alternative financial support projects are moving. Public-private cooperation directed at the financial support of small enterprises provides a "carrot" to encourage existing financial institutions to be more sensitive and responsive to the financial requirements of SEs.

49. References to innovative financial programmes usually include new institutional arrangements such as the Grameen Bank and its counterparts in other countries, rotating savings and loan associations, microlending and venture capital. The main purpose of establishing these programmes is to create favourable conditions for SE entrepreneurs to obtain financial resources on

reasonable terms. In this area, public-private interaction shows particular promise, as shown by the Bolivian Banco Solidario ("BancoSol"). Founded in 1992 as a microbank, today it is a fully fledged bank offering a wide range of savings schemes, with particular attention to small enterprises. With over 70,000 clients and a portfolio of US $40 million, it now serves one third of the country's banking customers.

50. An initial public subsidy permits a microbank to be set up to lend small amounts of money, with or without collateral, to pioneering and potential entrepreneurs. Once the initial financial resources are provided, the microbank can gain credibility as a sustainable and profit-oriented financial institution, and can attract deposits and borrow from commercial banks. It seems that some public subsidy to the fledgling financial institution is necessary for it to evolve to a self-sustainable commercial activity. The result is a "virtuous circle" in which public money catalyses private dollars. The experience of the BancoSol in Bolivia has demonstrated the potential roles of the government and private sector in building a specialized financial institution for small businesses. At the same time, this experience has confirmed the widespread idea that excessive subsidization of SEs would prove counterproductive in the long term, and that to have a concrete effect on the national economy, the financial institutions which supply credit and other financial services to small enterprises must first cover their costs and be profit-oriented themselves.

III. PROMOTION OF COMPETITION AND OTHER SOCIAL REGULATION

51. The more that is privatized and outsourced, the more crucial is the supervisory role of government in ensuring that the enlarged private sector, in following its private interests, is also meeting the requirements of society as a whole. A market economy requires clear and stable laws and regulations which are no more intrusive than necessary. The reform of the framework involves deregulation to free up activity and allow the emergence of self-regulating capacity in markets and civil society.

52. Regulation by government intervention in the free working of business and markets is traditionally justified by various well-known forms of market failure. There is a growing appreciation that market failure is not a sufficient justification, since intervention has an administrative cost. Also it may be misguided and result in stifling the emergence of competition. In fact, it is extremely difficult to establish a regulatory regime which is both expert and independent of capture by well-endowed enterprises (who may be supported by strong ministers), nor perverted by short-term political interests.

53. In the 1970s and 1980s there was great interest in regulation because of public discontent with the price, quality and cost performance of regulated firms. In the 1990s, strong trends to liberalization and demonopolization have ended the need for administrative regulation in some markets, because competitors (or potential competitors in a "contestable" market) do a much better job than governments of restraining unwarranted price increases and improving quality and variety. In competitive markets, the customer is king. Some traditional "natural" monopolies, such as telecommunications, are also becoming competitive, even with regard to basic line networks, by the

development of new technologies, such as wireless telephony and optic-fibre cable. Other natural monopolies can be subjected to competition by periodically auctioning each franchise to the highest bidder or, in a consumer-friendly variant, to the bidder who offers to supply at the lowest price.

54. However, the need for administrative regulation continues in markets dominated by monopolistic or oligopolistic suppliers. Regulation is moving up the political reform agenda because of privatization. Unfortunately, regulation is not popular in a time of privatization by disinvestment. When a government is trying to entice the private sector into bidding for public enterprises, it tends to postpone anything, such as regulation, which may dilute private interest. State enterprises, which normally carry with them monopoly powers inherited from an import-substitution and economies-of-scale era, will attract more bidders and fetch a better price if the new owners are allowed to continue their monopolies. Governments are often driven more by short-term fiscal considerations than efficiency arguments, so they avoid tackling this issue, promising themselves that they will return to it later, when everything is safely sold. By then, of course, enterprises are in a position to lobby for the maintenance of the protection and privileges which they paid for in the price. Where shareholdings are broadly based, it is politically difficult to reduce the dividend expectations of large numbers of voters.

55. On the other hand, there are two strong arguments in favour of regulation: (a) investors will prefer the security of pricing rules which are fixed and out of reach of arbitrary political interference; and (b) governments are worried about the distributional effects of monopolies, more so than their efficiency effects. Higher prices to poor electors are politically more damaging than the less visible effects of low efficiency. It is generally recommended that, since privatization is intended, inter alia, to increase efficiency and since it is important to keep prices of essential items to a minimum, competition must be promoted and, until it exists, it must be simulated by a system of regulation (Jones 1993). The general maxim is: competition where possible, regulation where necessary.

56. The current issues are concerned with choices between a cost-plus regime (typified by many United States utilities) or a price cap (typified by the RPI-X formula started in the United Kingdom); between a single regulator, a regulatory board, or sectoral regulatory agencies; whether to break up a national monopoly into regional monopolies; the rate at which competitors should be licensed, bearing in mind the need for the incumbent enterprise to finance major expansion as far as possible from internally generated surpluses; etc.

57. The choice between a cost-plus pricing formula and a price cap is usually represented as though cost means actual historic cost (in which case managers have no incentive to reduce costs), while a fixed price motivates managers to reduce costs (since this maximizes profit). In fact, the contrast is not so clear cut. If cost means future estimated or target cost (as in United States utilities) and if successive period price caps can be adjusted based on past profits (as in the United Kingdom), there is no difference in the incentive effects of the two bases. Cost-cutting incentives arise only by virtue of the period of time for which managers can operate before the next review (the longer the period, the stronger the incentive to cut costs).

58. The institutional form of monopoly regulation is a current issue in many developing and transitional countries. The United Kingdom and Argentina created a regulatory agency for each industry, but the recent trend is towards multi-sectoral agencies, as in Jamaica and Malaysia, which can pool cross-sectoral skills such as financial analysts, economists and lawyers. These also have advantages in standardizing regulatory systems, valuation methods, etc. and reducing cross-sectoral inconsistencies and inequities, as well as minimizing the transaction costs and delays inherent in setting up multiple institutions. Regulatory boards are more often preferred to single regulators in order to reduce the burden of individual accountability and opportunities for corrupt practices. In many countries, the corruption issue is very serious and regulatory regimes must be designed to keep regulatory discretion to a minimum, e.g. by relying more on potential competition, by making regulations very simple and automatic, and making regulatory decisions transparent (reasons to be given) and justiciable. Autonomous anti-corruption agencies, such as in Botswana, Sri Lanka and Singapore, can contribute to clean regulation.

IV. ROLE OF THE INTERNATIONAL COMMUNITY

59. In the third world, the government is the dominant institution in society. The problems of privatization and the enablement of business are all government problems. These new tasks are more difficult and complex than governments had before. New organizational structures have to be built, new skills imparted to carry out new functions, and new attitudes developed to displace a culture of risk avoidance and secrecy. Governments need to be able to analyse market conditions; set policy frameworks; draw up, negotiate and enforce contracts; regulate monopolies; coordinate, finance and support producers; enable community self-provision; and provide consumers with information on their options and remedies.

60. This is the challenge to governments. The challenge to the international community is to support them in these changes. At the World Economic Forum in Davos, Switzerland, last February, the Secretary-General said: "there is a new universal understanding that market forces are essential for sustainable development. Second, the role of the State is changing in most of the developing world, from one that seeks to dominate economic life, to one which creates the conditions through which sustainable development is possible." He called for a new partnership among governments, the private sector and the international community.

61. The dramatic increase in world trade, the emergence of powerful new trading blocs and the lack of direct foreign investment in the least developed countries (only 1 per cent of the total goes to 48 least developed countries) have contributed to the marginalization of the world's poorest nations. By contrast, United Nations assistance goes predominantly to low-income countries, where it should focus closely on establishing the conditions for private sector development.

62. This is in line with United Nations policy decisions. The General Assembly has said that United Nations activities, inter alia, should focus on the promotion of private sector involvement in development through public-private

partnerships and other interactions. It was specifically recommended that the sectoral and cross-sectoral agencies of the United Nations provide, on request from governments, independent evaluations and assessments of their privatization policies and programmes; that the United Nations should expand its assistance to the Member States concerned with military conversion; manage an information clearing house; develop enterprise conversion models; and provide technical support (General Assembly resolution 50/225 of 19 April 1996). Assembly resolution 50/106 of 20 December 1995 on business and development mandates United Nations agencies to foster active participation in support of entrepreneurship, privatization, demonopolization, the simplification of administrative procedures, and the encouragement of private-sector involvement in the efficient construction and maintenance of infrastructure. With respect to entrepreneurship, resolution 50/106 particularly valued the promotion of small and medium-sized enterprises. As a follow-up to this, the Economic and Social Council adopted resolution 1996/51 on action to be taken against bribery and corruption in international commercial transactions.

63. The twelfth Meeting of Experts on Public Administration and Finance (see A/50/525-E/1995/122) recommended that the United Nations Programme help governments define the role and scope of the public, mixed and private sectors and to suggest options in the modalities of interaction in accordance with the practical realities in each country, especially at the local and municipal levels, by means of specific technical assistance, dissemination and exchange of country experience and research on the conditions for successful replication. The United Nations can orchestrate governments and international agencies in addressing social needs through public-private interactions, and act as a facilitator in the sensitization to needs and in stimulating the flow of resources. Special attention should be given to the development of new services, e.g. in recreation, health and environmental protection, and to the development of reliable cost data.

64. In the area of infrastructure, the World Bank Group (the World Bank, IFC and MIGA) is active, not so much as a provider of capital as in the 1980s, but as a catalyst for private capital, and by encouraging governments to adopt business-friendly policies and systems and to develop local capital markets which will reduce dependence on foreign capital by mobilizing domestic savings and repatriating flight capital. The World Bank helps countries get access to limited recourse project financing by providing guarantees of syndicated bank loans and bond issues. As policy and institutional reforms take hold, the need for such support diminishes and is taken over by commercial institutions (Ferreira and Khatami, p. 27).

Notes

[1] In the period April 1996-January 1997, in-house providers got 148 awards totalling about £533 million, while private firms won 142 awards totalling about £270 million. Public Enterprise, February 1997, Emap Business Communications: London. To prevent underpricing by in-house providers, there are sanctions on local authorities which lose money on such contracts.

[2] Sandra Cointreau-Levine, Private Sector Participation in Municipal Solid Waste Services in Developing Countries, vol. 1, The Formal Sector, Washington, D.C.: World Bank 1994, pp. 22 and 26.

[3] News Straits Times, 30 July 1996.

[4] Berry, 1995, p. 1.

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